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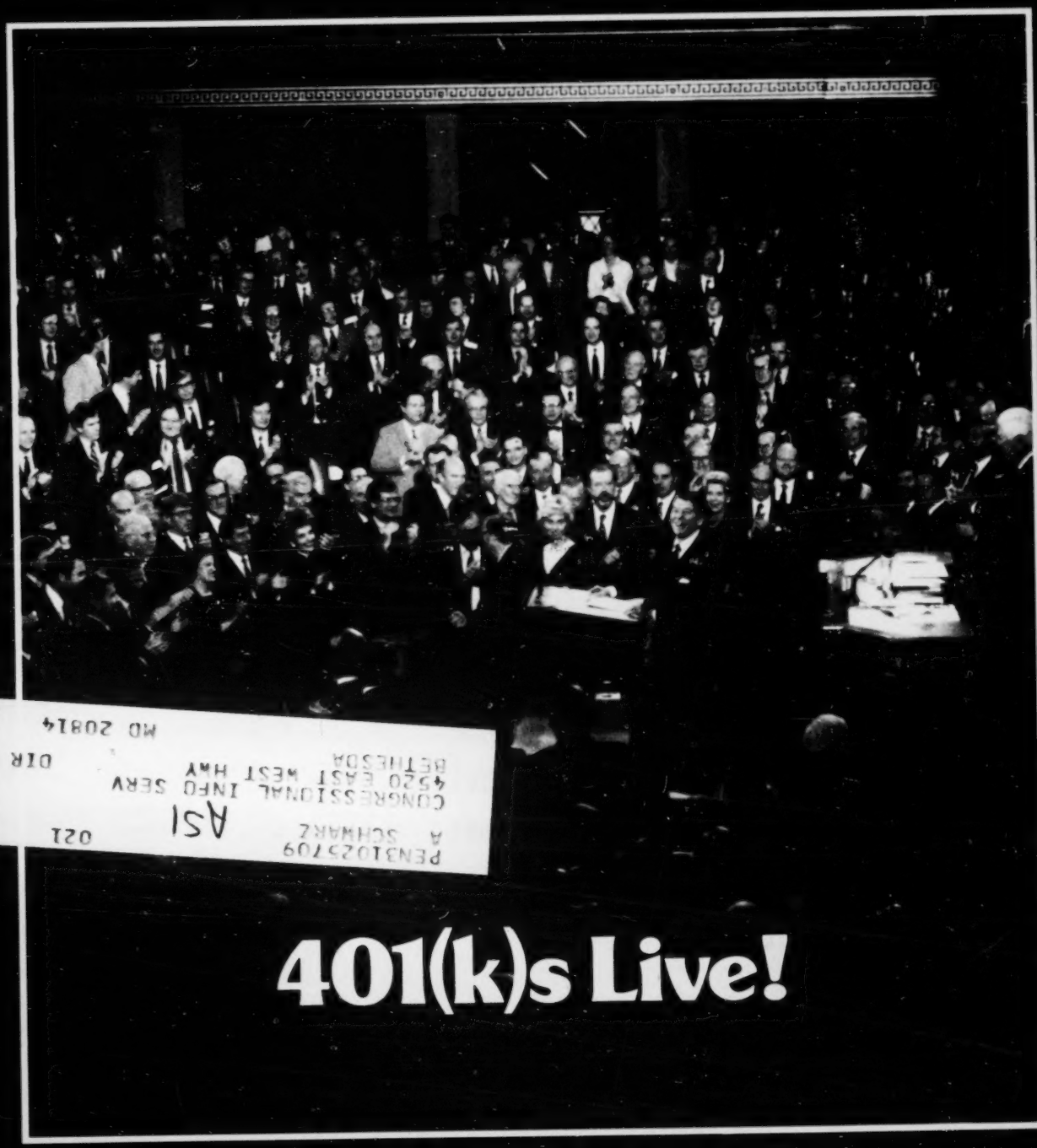
AUGUST 1986

Pension World

The Magazine for Plan Sponsors and Investment Managers/ A Publication of Communication Channels, Inc.



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401(k)s Live!

Is Tax Reform Good for Real Estate?

Pension World

August 1986
Volume 22 Number 8

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Cover: **Congress and the President have been working toward tax reform for the past year and a half. A final bill may be in sight. Photo by Keith Jewell, Office of the House Photographer.**

Pension World is published monthly by Communication Channels, Inc., George E. Fowkes, Chairman of the Board; B.J. Kotsher, President; Scott Smith, Secretary; Buford Bryant, Treasurer. Editorial and advertising offices at 6255 Barfield Road, Atlanta, GA 30328. Telephone (404) 256-9800. Telex 4611075COMCHANI. *Pension World* is a registered trademark of Communication Channels, Inc.

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Second class postage paid at Atlanta, GA, and at additional mailing offices. Subscription rates: U.S., 1 year, $41; 2 years, $68; Canada and Mexico, 1 year, $44; Overseas Sea Mail, $59; Overseas Air Mail, $81. Single copies, $3.50. Group rates available. The opinions expressed by authors and contributors to *Pension World* are not necessarily those of the editors or publisher.

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ISSN 0098-1753

401(k)s live!

Not only did a vigorous public education campaign save 401(k)s from the Congressional ax, it helped persuade more employers to establish new plans.

November 26, 1984 was an important day in the short history of the 401(k) plan. On that day, Treasury officials proposed to eliminate the popular retirement savings option as part of their deficit reduction, tax reform package. The business and related trade media quickly reported the issue and warned plan sponsors of impending doom for employers who would establish 401(k) plans during that "tax-reforming" political environment.

Fortunately however, Treasury I — the most serious effort to date to eliminate 401(k) plans — proved to be about as popular as Prohibition after World War I. In the short run, Congressional discussions and anticipated legislation to wipe out the retirement savings option did discourage a few employers from adopting new plans. The proposal was defeated, however, thanks largely to a concerted public education campaign that forced a good, hard look at the program and its beneficiaries.

This apparent victory should not lull us to sleep. We in the pension and employee benefit professions should continue public education and continue to ask Washington to leave Section 401(k) in its present form.

Public education

During their public awareness campaigns, consulting organization and insurance company surveys noted that participation was diversified from the lowest to the highest paid employees in most situations, and that 401(k) plans were fast becoming the most prevalent means of retirement savings. As many as 15 million employees now contribute to 401(k) plans, and 80 percent of the nation's largest employers either already have a plan or are about to adopt one for their employees. A recent survey of 2.7 million employees participating in 401(k) plans, conducted by the Employee Benefit Research Institute (EBRI), reveals that 54 percent earned less than $25,000. Another EBRI study found that the lower-earning two-thirds of participants contributed an average of 4.9 percent of compensation, while the upper-earning one-third contributed an average of 6.5 percent.

What was once falsely viewed as a retirement savings plan that favored the highly paid, was more appropriately identified as a plan that belonged to the rank and file in greater numbers. In fact, management and labor often joined to applaud the broad appeal of 401(k) and opposed, through heavy lobbying efforts, its repeal.

This public education campaign dealt an unexpected blow to the Treasury proposal. Rather than a decrease in the number of new plans established during this time of uncertainty, employers decided that the time was right to establish new 401(k) plans or convert into 401(k) plans existing profit sharing plans that were not meeting their intended objectives. Communication programs, at a level never seen before, became part and parcel of educating employees to the advantages of 401(k) on both the long- and short-term basis. In addition to the obvious tax advantages, partici-

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Table 1 **Comparison of Retirement Savings Options**

	401(k)	IRA	Regular Thrift	Voluntary Contributions	Private Savings
Maximum contribution	Up to $30,000 or 25% of earnings, subject to plan limits	$2,000 for an individual, $2,250 with spousal IRA	Up to 6% of earnings, subject to plan limits	Up to 10% of earnings	Unlimited
Federal tax treatment of deposits	Tax-deductible	Tax-deductible	Not deductible	Not deductible	Not deductible
Federal tax treatment of earnings	Tax-deferred until withdrawn	Tax-deferred until withdrawn	Tax-deferred until withdrawn	Tax-deferred until withdrawn	Taxable
Additional savings opportunities	Corporation match on contributions possible	No match	Corporate match on contributions	No match	No match
Access to funds	Withdrawals without tax penalty allowed at termination of employment, retirement, disability or death, and before age 59½ for hardship. Loans are available	10% tax penalty on withdrawals before age 59½ except for disability, death. Loans not permitted	Generally distributions only upon termination of employment, disability, death or retirement. Loans available	Withdrawals permitted at any time	Withdrawals possible at any time
Distribution requirements	Generally need not begin by age 70½ if individual is employed	Must begin by age 70½ if IRA. Not required if TDC	Generally need not begin by age 70½ if individual is employed	At any time	At any time
Preferential tax treatment available through 10 year income averaging	Yes	No	Yes	Yes	No

Source: State Mutual Life Assurance Company of America

pants were convinced they were contributing to their own financial security and protecting themselves against anticipated shortages in Social Security.

Public education successfully highlighted some of the following crucial points:

- participation in 401(k) plans makes it easy and convenient to pay yourself first through salary deferral;
- contributions are much higher with 401(k)s than with IRAs for many two-income families;
- matching company contributions are extremely attractive, as well as the ability to withdraw funds without penalty for hardship reasons;
- ten-year income averaging is an important tax advantage at distribution time because, through compound interest, one's account can grow to a substantial amount through systematic savings; and
- loans can be attractive features if plan sponsors are willing to accept the additional administrative work involved.

The accompanying tables compare five kinds of retirement options — 401(k)s, IRAs, regular thrift plans, voluntary contributions and private savings — and show how much an individual can save under each plan.

As a result of public education efforts, 401(k) supporters sent cards and letters to administrative and legislative officials and decision-makers proclaiming the same basic message: "Leave 401(k) plans alone." I attended a Southern Pension Conference meeting at which Senate Finance Committee Chairman Robert Packwood, R-Ore., commented that the quantity of mail received was so large that the daily count was determined by weighing the mail bags — they had actually determined the number of letters to a pound! This was additional proof of the popularity of 401(k) plans.

The success of 401(k)

One might ask: "Why was the 401(k) plan so popular as a savings vehicle in comparision to the well-publicized individual retirement accounts (IRAs) of the late 1970s and early 1980s?" There are of course many reasons, a primary one being the communication of 401(k) benefits to plan participants. This educational process took place at the employer-employee level, rather than at the seller-buyer level of the typical IRA. It was a lot less intimidating for an employee to accept the virtues of a 401(k) from his superior, for example, than an IRA solicitation from a banker, broker or insurance agent. The perception of a benefit provided rather than a product sold made employees more willing to accept 401(k)s. Participation by fellow employees at the company, including supervisors, made it prudent to jump onto the 401(k) bandwagon.

Genuine employer interest at both the economic and public relations levels also helped produce a top-down acceptance of the plans that assured widespread participation at all employee levels. It has been the norm to expect a 401(k) participation level of 70-80 percent — far greater than the 15-20 percent IRA participation.

As one of my former history professors taught me: "The truth is not often as important as what people perceive the truth to be." Tangible proof through quarterly or annual

Table 2 **Comparison of Retirement Savings Deposit**

	401(k)	IRA	Regular Thrift	Voluntary Contributions	Private Savings
Annual contribution	$ 2,000	$ 2,000	$ 2,000	$ 2,000	$ 2,000
Income tax on contribution (30%)	None	None	$ 600	$ 600	$ 600
Net contribution	$ 2,000	$ 2,000	$ 1,400	$ 1,400	$ 1,400
Total net contribution after 30 years	$ 60,000	$ 60,000	$ 42,000	$ 42,000	$ 42,000
Tax treatment on earnings during accumulation	None	None	None	None	Taxable as ordinary income
Net earnings after 30 years at 10% per year	$301,887	$301,887	$211,321	$211,321	$ 99,502
Account balance after 30 years	$361,887	$361,887	$253,321	$253,321	$141,502
Tax treatment on lump sum distribution	10 year income averaging	Ordinary income	10 year income averaging	10 year income averaging	Tax free since all taxes already paid
Amount of tax	$ 91,748	$177,414	$ 40,973	$ 40,973	None
Net account balance	$270,139	$184,473	$212,348	$212,348	$141,502

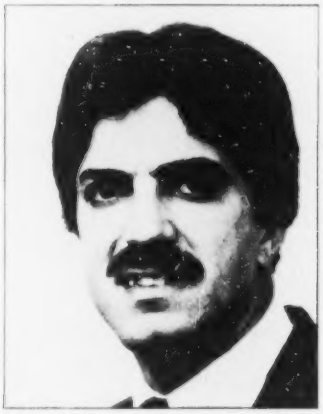
Source: State Mutual Life Assurance Company of America

employee statements provided by plan sponsors convinced employees that they had access to a real "employee benefit" program.

Traditional defined benefit plans provide a guaranteed benefit at retirement, but they have never been truly appreciated by most rank and file employees because tangible benefit evidence on a current basis is relatively meaningless to them. Annual defined benefit employee statements, for example, often show vested and projected benefits. The vested benefits are frequently low due to short service and graded vesting schedules. Therefore, the employee sees a low current benefit and a projected benefit that seems unobtainable and meaningless due to the length of time that one must work to achieve it. Defined benefit plans are also typically written on a final pay basis — the last five to 10 years of earnings — so it is difficult to determine one's eventual benefit. The "guaranteed benefit" feature of a defined benefit plan is often lost to the average participant because of the complexities of the plan. The work force has also become more mobile, lessening the appreciation of traditional plans. Vesting schedules of 10-15 years, typical in most defined benefit plans, are limited to five to six years in many 401(k) programs.

Matching employer contributions, often up to six percent of employee compensation, can be a strong motivational force to encourage employees to save for the future. It is not unusual to see relatively low wage earners contribute the maximum permitted under their "salary savings" program in order to take full advantage of the matching employer contributions. Although some employees may not understand the background or meaning of Section 401(k) of the Internal Revenue Code, they all can readily see and benefit from the results of these programs.

Profit-sharing thrift plans are not new. They have existed for many years. However, employee participation levels in these plans are much lower than in their 401(k) counterparts. This is due in part to after-tax versus pre-tax contributions, and, perhaps more importantly, employers did not promote the traditional matching plans as



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"It appears that very few proposals have judged 401(k) on its merits as a retirement savings program and instead have attacked it as a means to raise revenue. This intention appears obvious and could explain why 401(k) plans have been left alone to date. Sounder minds have prevailed when all aspects of the legislation and its effects on financial security were studied."

aggressively as they have the newer 401(k) plans. One reason for this greater promotion is the need to satisfy the qualification requirements of 401(k) plans that require non-discriminating contributions between the bottom two-thirds and the top one-third of all employees in the group. This practical application of the 401(k) thrift feature grew into genuine appreciation of the employer's role in the employees' savings and security program. The matching employer contribution has taken on new meaning.

A 1985 Hewitt Associates survey compared various 401(k) design characteristics, including matching contributions, with levels of participation. According to the survey results, participation was 64 percent when companies matched employee contributions dollar-to-dollar, compared to only 41 percent when plans provided no matching contributions. Generally, matching contributions will encourage both increased employee participation and increased levels of employee savings.

The proof was there. Employees were flocking to 401(k) programs in numbers that were never seen before. Treasury officials saw the potential loss of tax dollars and thus crusaded to repeal the 401(k) provisions. This view was short-sighted, however, because various studies (EBRI, e.g.) have shown that 60-75 percent of current tax-deferred dollars become taxable in future years. This is true because people pay taxes on larger incomes as they approach retirement. After all, this program is one of tax deferral, it is not a permanent tax shelter. This is a small price — 25 to 40 cents per dollar — to pay for the economic security of the average American, especially compared to the cost of a government-sponsored retirement savings program.

Judge 401(k) on merit

Legislative proposals have gone from outright repeals (November 1984) of 401(k) plans to limitations in their provisions. There have been so many proposals in the name of tax reform that it's often difficult to keep up with the latest version. Most have included reducing the maximum contribution from $30,000 to $7,000, taxing withdrawals prior to age 59½ with a 10-15 percent penalty, and removing the availability of 10-year income averaging. It appears that very few proposals have judged 401(k) on its merits as a retirement savings program and instead have attacked it as a means to raise revenue. This intention appears obvious and could explain why 401(k) plans have been left alone to date. Sounder minds have prevailed when all aspects of the legislation and its effects on financial security were studied.

On June 23, the Senate passed 97-3 its latest version of tax reform. This time it is the IRA plan that is threatened, not the 401(k). I think this confirms the recognition that 401(k) plans are truly broad-based. IRAs are being utilized by a select group of our population, while the 401(k) has broader participation.

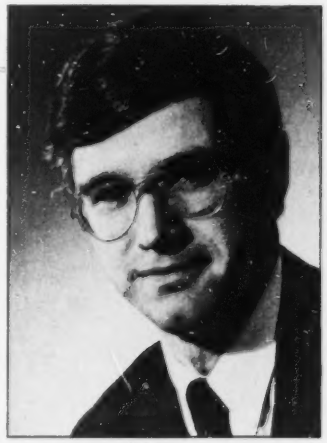
A 401(k) plan provides a significant retirement savings opportunity and can be adapted to meet most needs and objectives. I can only hope that our legislators will continue to recognize the 401(k) program for what it is — a valuable employee benefit. Washington should take the advice of many: "If it ain't broke, don't fix it." Section 401(k) of the Internal Revenue Code has been a blessing to many. Please, leave it alone. □

Real estate

Continued from page 16

We will also see more reports of foreclosures and bankruptcies of limited partnerships as they are unable to service high levels of debt incurred when properties were acquired by tax shelter syndicators. In many cases, these properties were purchased from parties related to the promoters at prices that were not necessarily arm's length and were financed at high levels to cover the purchase and to provide cash for fees payable to the promoters and others. Apartment properties are particularly involved in these circumstances. Because of their special tax treatment, they have been a more efficient vehicle for creating tax losses for sale to the public, and as a result have been both overpriced and overbuilt, especially in the Sunbelt.

But these problems are due to the 1981 tax reform, not the current one, and the retail and industrial markets will continue to show strength. We will not have to wait for the long term to see benefits to the real estate market following the proposed reforms. □



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Current Issues In Plan Design

Survey indicates states are holding down health plan costs

States have made great strides containing the cost of health benefit plans for their employees. Continuing commitment to health care cost management initiatives by the states has been a key factor for holding down these costs.

Martin E. Segal Company's 1986 update of its survey of state employee health benefit plans indicates that during the year ended January 1986 the increase in the average cost of state plans was substantially less than the rise in national medical care costs as measured by the Consumer Price Index (CPI). Several states reported decreases in the cost of coverage, and some have realized substantial savings as a result of the implementation of cost management programs and incentives for more cost effective health care.

In early 1986 the Segal survey was updated to reflect current contributions to the basic health benefit plans covering employees of all 50 states and the Virgin Islands. The three 1986 update tables show contributions for January 1986 and January 1985 for employee only coverage (Table 1), employee and family coverage (Table 2), and retiree only coverage (Table 3). In addition, the tables provide information on the percentage of the total cost paid by each state for the three types of coverage.

The 1986 update tables present contribution data for basic plans and do not include the numerous HMOs offered to state employees. For states with multiple benefit plans, the tables generally show contributions for only the "low" and "high" basic plans. Figures regarding average costs for the 51 state plans, and the distribution of plans by the percentage of the total cost paid by the state, are based on the low option plan for states with two basic plans shown in the tables.

Although averages conceal the very wide diversity in state employee health plan benefits and costs, the average total cost for employee only coverage increased approximately 3.5 percent between January 1985 and January 1986; this increase was about half the 6.9 percent rise in the medical component of the Consumer Price Index (CPI) during the same period. For employee and family coverage, the average total cost for the 51 state plans increased only 2.8 percent — or by just two-fifths of the 6.9 percent rise in national medical care costs — during the year ended January 1986. The average cost of providing health care benefits for a single retiree increased by an even smaller percentage than the cost of family coverage, 1.7 percent compared to 2.8 percent.

by **JOHN P. MACKIN**
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Employee only coverage

As of January 1986, 31 states were paying 100 percent of the cost for employee only coverage under at least one basic plan. Between 1985 and 1986, the distribution of state plans by the state's share of total cost for employee only coverage changed very little. From January 1985 to January 1986, the total cost percentage paid by the state for employee only coverage remained the same in 43 states, decreased in two and increased in six. States that increased their share of the cost include: California (87.8 to 100 percent for the low option plan), Colorado (81.6 to 87.5 percent), Ohio (84.4 to 100 percent for the low option plan) and Tennessee (70 to 80 percent).

During the year ended January 1986, the total cost for employee only coverage increased in 24 states, remained the same in 17 states and decreased in 10 states. This is in sharp contrast to last year's experience, when the comparable figures were 39, seven and five.

The average total cost for employee only coverage increased to $77.73 for January 1986 from $75.13 for January 1985, a 3.5 percent gain. The average state cost increased by a larger percentage than the average total cost — to $72.80 from $69.70 or by approximately 4.4 percent — because the average state share increased to 94 percent in 1986 from 93 percent in 1985.

Twelve states pay for the full cost of health benefits for employees and their dependents. The distribution of state plans by the state's share of the total cost for employee and family coverage changed only

Table 1

Monthly Contributions to State Employee Health Insurance Plans: 1985 and 1986
Employee Only Coverage

State	Cost to employee		Cost to state		Total cost		Percent of total cost paid by state	
	1985	1986	1985	1986	1985	1986	1985	1986
Alabama	0	0	100.00	105.00	100.00	105.00	100.0%	100.0%
Alaska	0	0	184.57	222.60	184.57	222.60	100.0	100.0
	0	0	234.84	237.75	234.84	237.75	100.0	100.0
Arizona	1.00	1.00	79.46	79.46	80.46	80.46	98.8	98.8
Arkansas	23.64	25.40	55.00	62.50	78.64	87.90	69.9	71.1
California	11.90	0	86.00	85.00	97.90	85.00	87.8	100.0
	37.17	39.39	86.00	85.00	123.17	124.39	69.8	68.3
Colorado	12.00	8.12	53.12	57.00	65.12	65.12	81.6	87.5
Connecticut	0	0	84.62	89.30	84.62	89.30	100.0	100.0
Delaware	0	0	73.90	72.48	73.90	72.48	100.0	100.0
	19.44	19.06	73.90	72.48	93.34	91.54	79.2	79.2
Florida	15.18	15.18	65.20	65.20	80.38	80.38	81.1	81.1
Georgia	13.60	13.60	62.95	62.65	76.55	76.25	82.2	82.2
	26.65	26.65	62.95	62.65	89.60	89.30	70.3	70.2
Hawaii	17.36	18.22	26.04	27.34	43.40	45.56	60.0	60.0
Idaho	0	0	73.10	69.52	73.10	69.52	100.0	100.0
Illinois	0	0	77.56	75.24	77.56	75.24	100.0	100.0
Indiana	1.58	1.58	72.45	72.45	74.03	74.03	97.9	97.9
Iowa	0	0	68.24	68.24	68.24	68.24	100.0	100.0
Kansas	0	0	83.42	78.53	83.42	78.53	100.0	100.0
Kentucky	0	0	53.82	60.22	53.82	60.22	100.0	100.0
Louisiana	39.52	39.52	39.52	39.52	79.04	79.04	50.0	50.0
Maine	0	0	67.08	72.56	67.08	72.56	100.0	100.0
Maryland	10.74	10.22	60.86	57.92	71.60	68.14	85.0	85.0
	20.58	19.54	60.86	57.92	81.44	77.46	74.7	74.8
Massachusetts	9.87	10.22	88.82	91.95	98.69	102.17	90.0	90.0
Michigan	11.12	11.12	100.14	100.14	111.26	111.26	90.0	90.0
Minnesota[a]	0	0	73.00	73.00	73.00	73.00	100.0	100.0
	—	6.48	—	73.00	—	79.48	—	91.8
Mississippi	0	0	58.80	72.00	58.80	72.00	100.0	100.0
Missouri	0	0	64.00	69.00	64.00	69.00	100.0	100.0
Montana	0	0	93.70	96.20	93.70	96.20	100.0	100.0
Nebraska	0	0	41.25	41.25	41.25	41.25	100.0	100.0
	11.89	11.26	44.47	44.47	56.36	55.73	78.9	79.8
Nevada	0	0	124.20	129.20	124.20	129.20	100.0	100.0
New Hampshire	0	0	61.03	67.96	61.03	67.96	100.0	100.0

slightly between 1985 and 1986.

Almost half (22) of the states were paying less than 70 percent of the total cost for employee and family coverage. In 10 of these 22 states the state's share was less than half the total cost for family coverage.

For the 50 states and the Virgin Islands, the average total cost for family coverage increased approximately 2.8 percent, to $178.09 for January 1986 from $173.18 for January 1985. The percentage increase in the average total cost for family coverage was only about two-fifths of the 6.9 percent rise in national medical care costs as measured by the CPI.

During the year ended January 1986, the state's share of the total cost for employee and family coverage increased in 14 states, remained the same in 31 and decreased in six. Although the percentage paid by the state varies from 100 to less than 40, the average state share for the 51 plans combined was 73 percent in 1986 compared to 72 percent in 1985. The average state cost for family coverage was 3.8 percent higher in January 1986 ($130.13) than in January 1985 ($125.41).

Among the 39 state plans where employees contribute for employee and family coverage, the average employee cost was $62.71 for January 1986. In seven of these 39 states the employee's out-of-pocket cost for family coverage exceeds $100 a month.

Retiree only coverage

Table 3 shows 1986 and 1985 contributions for a single retiree age 65 or over with Medicare. Contribution data are presented for 49 instead of 51 plans, because Indiana and Nebraska do not offer retired employees the opportunity to continue participating in the state health benefits plan.

Among the states that make access to coverage available to retirees, 23 make no contributions toward the cost of retiree health care benefits. In the 25 states and the Virgin Islands where the state makes some contribution toward

Table 1 **Employee Only Coverage (Cont'd.)**

State	Cost to employee 1985	Cost to employee 1986	Cost to state 1985	Cost to state 1986	Total cost 1985	Total cost 1986	Percent of total cost paid by state 1985	Percent of total cost paid by state 1986
New Jersey	0	0	58.93	65.89	58.93	65.89	100.0%	100.0%
New Mexico	17.27	15.30	51.79	45.88	69.06	61.18	75.0	75.0
	27.63	24.48	41.43	36.70	69.06	61.18	60.0	60.0
New York	0	7.51	74.44	67.66	74.44	75.17	100.0	90.0
	9.28	9.07	83.57	83.15	92.85	92.22	90.0	90.0
North Carolina	0.25	0.26	48.05	63.82	48.30	64.08	99.5	99.6
North Dakota	0	0	50.00	60.00	50.00	60.00	100.0	100.0
Ohio	12.75	0	68.95	68.95	81.70	68.95	84.4	100.0
	25.50	25.50	68.95	68.95	94.45	94.45	73.0	73.0
Oklahoma	0	0	115.31	115.31	115.31	115.31	100.0	100.0
Oregon	0	0	70.24	72.46	70.24	72.46	100.0	100.0
—BUBB Plan	0	0	136.70	144.90	136.70	144.90	100.0	100.0
Pennsylvania	0	0	54.30	57.81	54.30	57.81	100.0	100.0
	0	0	67.05	70.50	67.05	70.50	100.0	100.0
Rhode Island	0	0	52.15	77.97	52.15	77.97	100.0	100.0
South Carolina	0	0	58.21	62.29	58.21	62.29	100.0	100.0
	6.56	7.02	58.21	62.29	64.77	69.31	89.9	89.9
South Dakota	0	0	50.72	53.42	50.72	53.42	100.0	100.0
Tennessee	20.07	11.70	46.82	46.82	66.89	58.52	70.0	80.0
Texas[b]	0	0	66.29	66.29	66.29	66.29	100.0	100.0
	0	—	86.27	—	86.27	—	100.0	—
Utah	8.25	8.25	74.25	74.25	82.50	82.50	90.0	90.0
Vermont	8.65	8.65	34.58	34.58	43.23	43.23	80.0	80.0
Virginia	0	0	65.52	71.16	65.52	71.16	100.0	100.0
Washington	0	0	64.52	64.52	64.52	64.52	100.0	100.0
West Virginia	0	0	79.95	79.95	79.95	79.95	100.0	100.0
Wisconsin[c]	9.38	12.31	69.74	72.69	79.12	85.00	88.1	85.5
Wyoming	5.94	5.94	100.00	100.00	105.94	105.94	94.4	94.4
Virgin Islands	27.41	27.41	27.41	27.41	54.82	54.82	50.0	50.0

[a]Minnesota used only one rate in 1985.
[b]Texas used only one rate in 1986.
[c]Contributions vary by benefit plan and by county. State pays lesser of 90% of standard plan rate or 105% of lowest cost HMO in employee's county. Rates shown in table are for standard plan in Dane County (Madison).

Where two sets of figures are listed for a state, they represent the "low" and "high" basic plans.

retiree coverage, the state's share as of January 1986 varied as follows: 13 states paid 100 percent of the cost of coverage for a single retiree; six paid between 80 and 91 percent; two paid 50 percent and the remaining five paid less than half the total cost for a single retiree.

Among the 49 plans that make access to coverage available to retirees, the average cost of coverage for a single retiree 65 or over with Medicare was $52.36 for January 1986, or just 1.7 percent higher than the $51.47 average for January 1985. During the year ended January 1986, the average state share remained at approximately 49 percent of the average total cost for a single retiree.

Half the states, including Indiana and Nebraska, currently make no contributions toward the cost of retiree health care coverage. Over the next several years these states are likely to see much greater pressures from retirees to pay for part or all of the cost of their health care coverage. In some states, programs may also be established to start funding retirees' health care benefits on a level cost basis during the employees' working years.

Cost management initiatives

State employee health benefit plans utilize a variety of cost management techniques. Most state plans have added traditional types of cost management provisions, and some have instituted innovative nonconventional programs.

As part of the Segal Company's 1986 update of its survey of state employee health benefit plans, informative was obtained on the cost management steps that various states have put into effect. Among state plans, the major new development in the health care cost management arena is the adoption of precertification and preadmission review programs. In the past year alone, nearly one-third of all states incorporated such programs in their health benefit plans. Here is a brief overview of cost management initiatives recently implemented by state plans:

- **HMOs** — More than two-thirds

Table 2

Monthly Contributions to State Employee Health Insurance Plans: 1985 and 1986
Employee and Family Coverage

State	Cost to employee		Cost to state		Total cost		Percent of total cost paid by state	
	1985	1986	1985	1986	1985	1986	1985	1986
Alabama	82.50	82.50	100.00	105.00	182.50	187.50	54.8%	56.0%
Alaska	0	0	184.57	222.60	184.57	222.60	100.0	100.0
	0	0	234.84	237.75	234.84	237.75	100.0	100.0
Arizona	70.50	59.78	150.98	150.98	221.48	210.76	68.2	71.6
Arkansas	47.52	50.58	55.00	62.50	102.52	113.08	53.6	55.3
	73.08	77.54	55.00	62.50	128.08	140.04	42.9	44.6
California	39.20	8.67	209.00	211.00	248.20	219.67	84.2	96.1
	100.88	97.38	209.00	211.00	309.88	308.38	67.4	68.4
Colorado	121.00	117.12	53.12	57.00	174.12	174.12	30.5	32.7
Connecticut	42.26	44.56	183.18	193.34	225.44	237.90	81.3	81.3
Delaware	0	0	181.76	178.26	181.76	178.26	100.0	100.0
	46.80	45.90	181.76	178.26	228.56	224.16	79.5	79.5
Florida	55.64	55.64	122.80	122.80	178.44	178.44	68.8	68.8
Georgia	39.80	39.80	107.15	109.50	146.95	149.30	72.9	73.3
	66.00	66.00	107.15	109.50	173.15	175.50	61.9	62.4
Hawaii	53.36	56.03	80.04	84.05	133.40	140.08	60.0	60.0
Idaho	66.74	63.40	73.10	69.52	139.84	132.92	52.3	52.3
Illinois	67.18	67.18	98.56	96.32	165.74	163.50	59.5	58.9
	123.02	123.02	98.56	96.12	221.58	219.14	44.5	43.9
Indiana	36.66	36.66	178.01	178.01	214.67	214.67	82.9	82.9
Iowa	57.76	57.76	99.20	99.20	156.96	156.96	63.2	63.2
Kansas	137.19	127.39	83.42	78.53	220.61	205.92	37.8	38.1
Kentucky	80.92	83.94	53.82	60.22	134.74	144.16	39.9	41.8
Louisiana	90.96	90.96	90.96	90.96	181.92	181.92	50.0	50.0
Maine	48.58	52.46	119.66	129.46	168.24	181.92	71.1	71.2
Maryland	31.62	30.08	179.18	170.48	210.80	200.56	85.0	85.0
	56.46	53.78	179.18	170.48	235.64	224.26	76.0	76.0
Massachusetts	21.32	22.16	191.83	199.48	213.15	221.64	90.0	90.0
Michigan	31.16	31.16	280.52	280.52	311.68	311.68	90.0	90.0
Minnesota[a]	9.34	9.34	157.18	157.18	166.52	166.52	94.4	94.4
	—	25.82	—	157.18	—	183.00	—	85.9
Mississippi	89.70	89.70	58.80	72.00	148.50	161.70	39.6	44.5
Missouri	109.00	151.75	64.00	69.00	173.00	220.75	37.0	31.3
Montana	40.70	61.20	100.00	105.00	140.70	166.20	71.1	63.2
Nebraska	0	0	147.68	147.68	147.68	147.68	100.0	100.0
	42.58	39.95	159.23	159.23	201.81	199.18	78.9	79.9

of the states offer employees the option of participating in one or more health maintenance organizations. In several states HMOs have gone beyond the conventional and offer more benefits than the standard plan.

A number of states have recently augmented the use of HMOs. For example, Kentucky now offers 11 HMOs, and Illinois and Michigan allow employees to participate in 19 HMOs. South Carolina recently introduced HMOs on a statewide basis, and New Jersey added two for a total of 13. Wisconsin offers 24 HMOs in various geographic areas of the state, having added four effective January 1, 1986; about 60 percent of all active and retired Wisconsin employees currently participate in HMOs.

• **PPOs** — Preferred provider organizations, which have generated widespread interest in the private sector, are beginning to be implemented by the states. Two large states — Illinois and New York — recently established PPO networks and project that the new plans will result in substantial savings in health care costs. Alabama just established a network of preferred medical doctors and is considering creating a PPO for pharmacists. Oklahoma's new PPO option became available on January 1, 1986, and Tennessee recently began participating in a statewide hospital-based PPO.

Other states that have PPOs in place include California, Florida, Minnesota, Nevada, Pennsylvania and Utah. Utah's preferred provider arrangements with hospitals and surgical centers have been in effect for three years; the Utah PPO network was enlarged this year by adding new hospitals and clinics. For some preferred providers, Utah uses a draft system under which direct payments are made to the provider and no claim form is required on the part of the employee. Several additional states are currently evaluating the feasibility and potential cost savings that may result from

Table 2 **Employee and Family Coverage (Cont'd.)**

State	Cost to employee 1985	Cost to employee 1986	Cost to state 1985	Cost to state 1986	Total cost 1985	Total cost 1986	Percent of total cost paid by state 1985	Percent of total cost paid by state 1986
Nevada	87.16	69.73	124.20	129.20	211.36	198.93	58.8%	64.9%
New Hampshire	0	0	169.78	183.50	169.78	183.50	100.0	100.0
New Jersey	0	0	143.83	160.56	143.83	160.56	100.0	100.0
New Mexico	45.23	39.57	135.67	118.69	180.90	158.26	75.0	75.0
	72.36	63.31	108.54	94.95	180.90	158.26	60.0	60.0
New York	0	29.19	158.95	132.77	158.95	161.96	100.0	82.0
	35.46	34.53	162.11	163.33	197.57	197.86	82.1	82.5
North Carolina	77.23	89.54	48.05	63.82	125.28	153.36	38.4	41.6
North Dakota	0	0	140.00	168.00	140.00	168.00	100.0	100.0
Ohio	30.57	0	165.27	165.27	195.84	165.27	84.4	100.0
	61.13	61.13	165.27	165.27	226.40	226.40	73.0	73.0
Oklahoma	108.00	108.00	115.31	115.31	223.31	223.31	51.6	51.6
Oregon	0	0	126.39	130.41	126.39	130.41	100.0	100.0
—BUBB Plan	0	0	136.70	144.90	136.70	144.90	100.0	100.0
Pennsylvania	0	0	131.35	139.33	131.35	139.33	100.0	100.0
	0	0	179.36	189.81	179.36	189.81	100.0	100.0
Rhode Island	0	0	136.88	207.86	136.88	207.86	100.0	100.0
South Carolina	57.12	61.12	58.21	62.29	115.33	123.41	50.5	50.5
	67.38	72.10	58.21	62.29	125.59	134.39	46.3	46.4
South Dakota	122.36	130.74	50.72	53.42	173.08	184.16	29.3	29.0
Tennessee	50.09	29.22	116.89	116.89	166.96	146.11	70.0	80.0
Texas[b]	88.36	88.36	87.00	87.00	175.36	175.36	49.6	49.6
	144.48	—	87.00	—	231.48	—	37.6	—
Utah	21.82	21.82	196.39	196.39	218.21	218.21	90.0	90.0
Vermont	23.99	23.99	95.98	95.98	119.97	119.97	80.0	80.0
Virginia	48.30	52.52	118.48	128.60	166.78	181.12	71.0	71.0
Washington	0	0	183.56	183.56	183.56	183.56	100.0	100.0
West Virginia	0	0	187.95	187.95	187.95	187.95	100.0	100.0
Wisconsin[c]	19.33	26.00	173.93	181.89	193.26	207.89	90.0	87.5
Wyoming	111.42	111.42	100.00	100.00	211.42	211.42	47.3	47.3
Virgin Islands	74.68	74.68	27.41	27.41	102.09	102.09	26.8	26.8

[a]Minnesota used only one rate in 1985.
[b]Texas used only one rate in 1986.
[c]Contributions vary by benefit plan and by county. State pays lesser of 90% of standard plan rate or 105% of lowest cost HMO in employee's county. Rates shown in table are for standard plan in Dane County (Madison).

Where two sets of figures are listed for a state, they represent the "low" and "high" basic plans.

establishing various types of PPO networks.

• **Second Opinions** — Second surgical opinion programs are now common features of state employee health benefit plans. Many of these programs include incentive features like 100 percent reimbursement or bonus payments, and a growing number require second opinions for specified surgical procedures.

State plans that provide 100 percent reimbursement for second opinions include Alaska, Arizona, Louisana, Mississippi, Missouri, New Mexico, Oregon, Pennsylvania and West Virginia. Utah not only pays 100 percent for second opinions but also pays an incentive bonus to the employee. Second opinions are now mandatory for selected surgeries in an increasing number of plans, including those in Arizona, Colorado, Nebraska, New Hampshire, Oklahoma, Virginia and Washington.

• **Outpatient Services** — Several states have recently amended their plans to provide incentives for outpatient surgery and for diagnostic and preadmission tests performed on an outpatient basis. During the past two years, almost one-fifth of the state plans have increased the reimbursement percentage to 100 percent for outpatient services. By contributing to the decrease in the use of hospital inpatient services, the outpatient incentives adopted by state plans have helped to reduce the overall rate of inflation in health care costs.

• **Precertification Programs** — Among state employee health benefit plans, the major new development in the area of health care cost management is the adoption of precertification programs. In 1986 alone, nearly one-third of the state plans instituted some type of precertification, preadmission review or case management program. States that added such programs include California, Colorado, Florida, Idaho, Illinois, Kansas, Kentucky, Michigan, Nebraska, North Carolina, North Dakota, Okla-

Table 3

Monthly Contributions to State Employee Health Insurance Plans: 1985 and 1986
Retiree Only Coverage (Over 65 with Medicare)

State	Cost to retiree		Cost to state		Total cost		Percent of total cost paid by state	
	1985	1986	1985	1986	1985	1986	1985	1986
Alabama	50.90	34.35	0	22.35	50.90	56.70	0 %	39.4%
Alaska	0	0	191.85	175.00	191.85	175.00	100.0	100.0
Arizona	67.68	67.68	0	0	67.68	67.68	0	0
Arkansas	37.50	41.50	0	0	37.50	41.50	0	0
California	0	0	67.51	51.70	67.51	51.70	100.0	100.0
	6.68	10.53	86.00	85.00	92.68	95.53	92.8	89.0
Colorado	0	0	48.12	48.12	48.12	48.12	100.0	100.0
Connecticut	26.59	25.59	21.76	20.94	48.35	46.53	45.0	45.0
Delaware	3.26	3.20	31.80	31.18	35.06	34.38	90.7	90.7
	21.78	21.36	31.80	31.18	53.58	52.54	59.4	59.3
Florida	55.30	55.30	0	0	55.30	55.30	0	0
Georgia	13.60	13.60	62.95	62.65	76.55	76.25	82.2	82.2
	26.65	26.65	62.95	62.65	89.60	89.30	70.3	70.2
Hawaii	0	0	51.08	53.64	51.08	53.64	100.0	100.0
Idaho	35.54	35.54	10.66	5.68	46.20	41.22	23.1	13.8
Illinois	0	0	77.56	75.24	77.56	75.24	100.0	100.0
Indiana	—	—	—	—	—	—	—	—
Iowa	31.90	31.90	0	0	31.90	31.90	0	0
Kansas	39.86	36.59	0	0	39.86	36.59	0	0
Kentucky	48.75	51.75	0	0	48.75	51.75	0	0
Louisiana	20.62	20.62	20.62	20.62	41.24	41.24	50.0	50.0
Maine	0	0	31.36	37.12	31.36	37.12	100.0	100.0
Maryland	9.02	7.90	51.16	44.76	60.18	52.66	85.0	85.0
	21.50	21.12	51.16	44.76	72.66	65.88	70.4	67.9
Massachusetts	6.63	6.65	59.64	59.86	66.27	66.51	90.0	90.0
Michigan	0	0	75.57	75.57	75.57	75.57	100.0	100.0
Minnesota	51.28	51.28	0	0	51.28	51.28	0	0
Mississippi	34.50	34.50	0	0	34.50	34.50	0	0
Missouri[a]	35.50	33.75	3.00	3.00	38.50	36.75	7.8	8.2
	—	60.00	—	3.00	—	63.00	—	4.8
Montana	49.00	61.00	0	0	49.00	61.00	0	0
Nebraska	—	—	—	—	—	—	—	—

homa, Tennessee, Virginia and Wyoming.

The specific provisions of precertification programs differ among the state plans. Some require precertification for all hospital admissions, while other plans mandate the precertification requirement only for certain types of admissions. In several states, including Colorado, Illinois, Kentucky, Nebraska, Oklahoma, Tennessee and Virginia, the precertification program encompasses additional features such as concurrent review, case management review, discharge planning and hospital length of stay assignments.

Although the cost effects of the various types of precertification programs are difficult to quantify, a number of states anticipate that the recent introduction of these programs will reduce the number of hospital admissions and considerably shorten average hospital stays for specified procedures.

• **Other Provisions** — Certain cost management provisions have been introduced by a few state plans and may become more widespread in the future. These include limitations on benefits for weekend admissions, providing benefits for services rendered by birthing centers, home health care benefits, hospice benefits and 100 percent reimbursement for generic drugs.

Although several states have considered adding benefits to promote good health, few currently provide so-called wellness benefits or incentives for healthier lifestyles. New York and Utah are two states that have instituted programs to promote good health. North Dakota adopted a new wellness program run by local health departments.

A few states have recently implemented new cost-effective plan designs that incorporate several cost management provisions. These plans have been introduced with the dual objectives of providing more cost-effective care and making employees cost conscious consumers of health care.

In conclusion, many states have been successful in holding down the costs of health benefit plans for their employees. From January 1985 to January 1986, the average cost of state employee health benefit plans increased by substantially less than national medical care costs as measured by the CPI. Because a state is often the largest employer within its own borders, it is clear that the cost management steps taken by state plans can influence providers and help make our health care system more cost effective. □

Table 3 **Retiree Only Coverage (Cont'd.)**

State	Cost to employee 1985	Cost to employee 1986	Cost to retiree 1985	Cost to retiree 1986	Total cost 1985	Total cost 1986	Percent of total cost paid by state 1985	Percent of total cost paid by state 1986
Nevada	61.68	56.89	29.81	34.81	91.49	91.70	32.8%	38.0%
New Hampshire	0	0	37.21	40.00	37.21	40.00	100.0	100.0
New Jersey[b]	43.71	45.00	0	0	43.71	45.00	0	0
New Mexico	46.50	46.50	0	0	46.50	46.50	0	0
New York[c,d]	9.28	9.07	83.57	81.59	92.85	90.66	90.0	90.0
North Carolina	0	0	36.32	48.58	36.32	48.58	100.0	100.0
North Dakota	44.00	50.00	0	0	44.00	50.00	0	0
Ohio	0	0	49.90	50.00	49.90	50.00	100.0	100.0
Oklahoma	45.90	45.90	0	0	45.90	45.90	0	0
Oregon	34.98	36.03	0	0	34.98	36.03	0	0
	43.78	43.78	0	0	43.78	43.78	0	0
Pennsylvania	0	0	43.75	57.78	43.75	57.78	100.0	100.0
	0	0	56.45	68.93	56.45	68.93	100.0	100.0
Rhode Island	34.60	41.37	0	0	34.60	41.37	0	0
South Carolina	0	0	50.50	54.04	50.50	54.04	100.0	100.0
South Dakota	49.22	51.92	0	0	49.22	51.92	0	0
Tennessee	33.96	33.96	0	0	33.96	33.96	0	0
Texas[e]	0	0	66.29	66.29	66.29	66.29	100.0	100.0
	0	—	85.02	—	85.02	—	100.0	—
Utah	49.50	54.50	0	0	49.50	54.50	0	0
Vermont	3.54	3.54	14.17	14.17	17.71	17.71	80.0	80.0
Virginia	30.96	37.16	0	0	30.96	37.16	0	0
Washington	38.86	38.86	0	0	38.86	38.86	0	0
West Virginia	23.95	23.97	0	0	23.95	23.97	0	0
Wisconsin[c,f]	51.43	57.15	0	0	51.43	57.15	0	0
Wyoming	44.12	44.12	0	0	44.12	44.12	0	0
Virgin Islands	21.19	21.19	21.18	21.18	42.37	42.37	50.0	50.0

[a]Missouri used only one rate in 1985.
[b]State pays total cost for employees who retire with 25 or more years of credited service or retire on a disability pension.
[c]Sick leave credits may be used by retirees to pay premiums.
[d]State pays total cost for employees who retired before 1983.
[e]Texas used only one rate in 1986.
[f]Rates shown are for standard plan.

Where two sets of figures are listed for a state, they represent the "low" and "high" basic plans.

Teacher unions

Continued from page 40

trustee, NCTR Convention, Palm Beach, Florida, October 1, 1983.

7. *California Teachers Ass'n v. Cory,* 202 Cal. 3d 611-627 (1984).

8. In the two years following Thome's retirement, there were four different executive directors.

9. Interview with Mike Thome, executive director, California Teachers' Retirement System, at the NCTR Convention, Seattle, Washington, October 7, 1982.

10. This research has identified only the issues and how they have been influenced to some degree by politics. More study of the pension politics in this state could prove useful in defining the various forces.

11. Attached to the legislation was a nonseverability clause that said if the courts found any one part of the legislation unenforceable, the entire legislation would be inoperative.

12. *Pennsylvania Bulletin* 13, 45 (November 5, 1983): 3479-81.

13. Interview with Harvey Schmidt, executive director, Minnesota Educational Retirement Fund, meeting of National Conference of Public Employee Retirement Systems, San Antonio, Texas, April 12, 1983.

14. Interview with F. Michael Brennan, legislative director, Wisconsin Education Association, Madison, Wisconsin, January 5, 1983. Wisconsin's government relations director stated that while his teachers' system is financially sound and well funded, the benefits do lag behind those of several other states.

15. Interview with Richard Nichols, member, Washington Education Association, Phoenix, Arizona, November 4, 1983.

16. In an interview with R. H. Hollister, executive director, Washington State Retirement Systems, Seattle, Washington, October 8, 1982, he explained that he attempts to maintain good relations with the press and to be open and communicative about the system.

17. Interview with Richard Nichols.

18. One example of this is that for many years the position of executive director has been held by a former state senator.

19. National Education Association, *Estimates of Statistics,* Washington, D.C., numerous years; interview with John Sullivan, executive director, South Carolina Education Association, Columbia, South Carolina, March 25, 1983.

20. Without union opposition, the system went from a 4 percent employee and 8 percent employer contribution to a totally state contributory system, with a reduction from 2 percent per year defined benefit to 1.65 percent and Social Security. Only six thousand teachers continue in the old contributory system as of 1984.

21. Interview with Doug Mann, research director, Florida Retirement System, Tallahassee, Florida, March 28, 1983.

22. C. C. Elebash, "A New Strategy Strengthens Public Pension Fund Returns," *Florida Trend* (October 1982): 53.

23. Scott J. Paltrow, "Official's Disappearance, Loan Procedures Cloud Risky Investment by Teachers Fund," *Wall Street Journal* (August 17, 1983).

24. Interviews with various staff members of AEA and with other pension personnel, Phoenix, February 7 and 8, 1983, revealed that extensive reorganization of the AEA diminished the political involvement of staff. A subsequent interview with AEA members, New Orleans, November 10, 1985, revealed that the charges assessed the state and the employee for pension costs had been reduced for each from 7.00 percent of payroll, in effect from 1975 through 1983, to 6.27 percent in 1984 and 1985.